World Investment Report 1997:
Transnational Corporations, Market Structure and Competition Policy

Overview

Foreign direct investment (FDI) continues to be a driving force of the globalization process that characterizes the modern world economy. The current boom in FDI flows, which has been accompanied by increasing flows of foreign portfolio equity investments, underscores the increasingly important role played by transnational corporations (TNCs) in both developed and developing countries. This role has been facilitated by the liberalization of FDI policies that has taken place in many countries in recent years, as part of an overall movement towards more open and market-friendly policies. However, reaping the benefits of FDI liberalization requires not only that barriers to FDI are reduced and standards of treatment established — the focus of most FDI liberalization to date — but also that competition in markets is maintained. This third component of FDI liberalization — maintaining the proper functioning of markets in which TNCs invest — is the special topic of this year's *World Investment Report*, which examines the interaction between FDI, market structure and competition, and looks at policy implications.

GLOBAL AND REGIONAL TRENDS

The growing size and importance of international production ...

With some $6.4 trillion in global sales in 1994 (and estimated global sales of $7 trillion in 1995) -- the value of goods and services produced by some 280,000 foreign affiliates -- international production outweighs exports as the dominant mode of servicing foreign markets (table 1). The growth of global sales has exceeded that of exports of goods and services by a factor of 1.2 to 1.3 since 1987. But as far as developing countries are concerned, despite their growing involvement in international production — of the world's 44,000 parent firms, 7,900 firms were based in developing countries in the mid-1990s (table 2), compared to 3,800 in the late 1980s — exports continue to be the principal mode of delivering goods and services to foreign markets.

The gross product of foreign affiliates, a measure of their output, almost tripled between 1982 and 1994, and its share of world output rose slightly, from 5 per cent in 1982 to 6 per cent in 1994. In developing countries, the output of foreign affiliates has contributed (in 1994) more to gross domestic product than it has in developed countries: 9 per cent compared to 5 per cent.

The global FDI stock, a measure of the investment underlying international production, increased fourfold between 1982 and 1994; over the same period, it doubled as a percentage of world gross domestic product to 9 per cent. In 1996, the global FDI stock was valued at $3.2 trillion. Its rate of growth over the past decade (1986-1995) was more than twice that of gross fixed capital formation, indicating an increasing internationalization of national production systems. The worldwide assets of foreign affiliates, valued at $8.4 trillion in 1994, also increased more rapidly than world gross fixed capital formation.

The upward trend manifested in all of the indicators of international production, in absolute terms as well as in relation to various macroeconomic indicators, suggests that international

Table 1. Selected indicators of FDI and international production, 1986-1996

(Billions of dollars and percentage)

Item	Value at current prices (Billion dollars) 1995	1996	Annual growth rate (Per cent) 1986-1990	1991-1996	1995	1996
FDI inflows	317	349	24.4	17.1	32.6	10.3
FDI outflows	339	347	27.0	11.8	34.9	2.4
FDI inward stock	2 866	3 233	18.7	11.7	18.2	12.8
FDI outward stock	2 811	3 178	19.8	11.1	15.1	13.1
Cross-border mergers and acquisitions[a]	141	163	21.0[b]	27.1	28.8	15.5
Sales of foreign affiliates	5 933[c]	6 412[d]	17.3	4.0[e]	12.5[c]	8.1[d]
Gross product of foreign affiliates	1 363[c]	1 557[d]	19.1	3.3[e]	- 2.9[c]	14.2[d]
Total assets of foreign affiliates	7 091[c]	8 343[d]	19.9	11.2[e]	13.1[c]	17.7[d]
Memorandum:						
GDP at factor cost	28 264	30 142	10.7	6.4	9.5	6.6
Gross fixed capital formation	6 088	..	10.7	4.5[f]	12.4	..
Royalties and fees receipts	48	..	21.9	12.0[f]	16.4	..
Exports of goods and non-factor services	5 848	6 111	14.3	7.4	16.2	4.5

Source: UNCTAD, *World Investment Report 1997*, p. 4.

[a] Majority-held investments only.
[b] 1987-1990.
[c] 1993.
[d] 1994.
[e] 1991-1994.
[f] 1991-1995.

Note: not included in this table are the value of worldwide sales by foreign affiliates associated with their parent firms through non-equity relationships and the sales of the parent firms themselves.

Table 2. Number of parent corporations and foreign affiliates, by area and country, latest available year

(Number)

Area/economy	Parent corporations based in country	Foreign affiliates located in economy [a]
Developed countries	36380	93628
Western Europe	26161	61902
European Union	22111	54862
Japan	3967 [b]	3405 [c]
United States	3470 [d]	18608 [e]
Developing countries	7932	129771
Africa	30	134
Latin America and the Caribbean	1099	24267
South, East and South-East Asia	6242	99522
West Asia	449	1948
Central and Eastern Europe	196	53260
World	44508	276659

Source: UNCTAD, *World Investment Report 1997*, p. 6.

a Represents the number of foreign affiliates in the economy shown, as defined by it (see section on definitions and sources in the annex).

b The number of parent companies not including finance, insurance and real estate industries in March 1995 (3,695) plus the number of parent companies in finance, insurance and real estate industries in December 1992 (272).

c The number of foreign affiliates not including finance, insurance and real estate industries in March 1995 (3,121) plus the number of foreign affiliates, insurance and real estate industries in November 1995 (284).

d Represents a total of 2,658 non-bank parent companies in 1994 and 89 bank parent companies in 1989 with at least one foreign affiliate whose asset, sales or net income exceeded $3 million, and 723 non-bank and bank parent companies in 1989 whose affiliate(s) had assets, sales and net income under $3 million.

e Represents a total of 12,523 bank and non-bank affiliates in 1994 whose assets, sales or net income exceeded $1million, and 5,551 bank and non-bank affiliates in 1992 with assets, sales and net income under $1 million, and 534 United States affiliates that are depository institutions. Each affiliate represents a fully consolidated United States business entreprise, which may consist of a number of individual companies.

Note: the data can vary significantly from preceding years, as data become available for countries that had not been covered before, as definitions change, or as older data are updated.

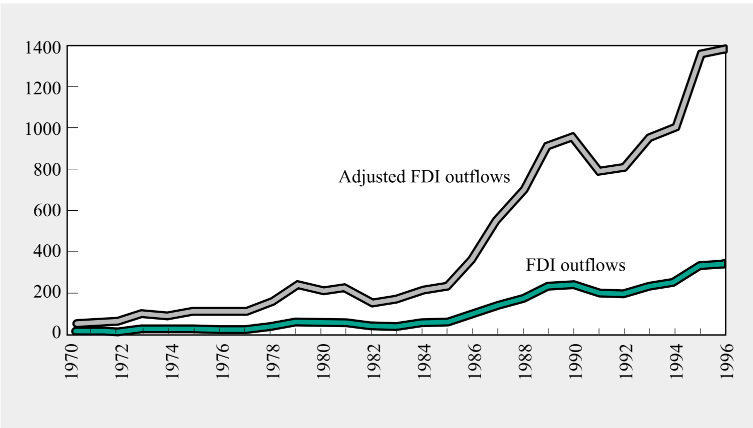
production is becoming a more significant element in the world economy. Its importance is apparent in the activities in which TNCs are involved. On the technology side, for example, an estimated 70 per cent of the global payments of royalties and fees constitute transactions between parent firms and their foreign affiliates.

... was manifested in 1996 in the $1.4 trillion worth of investment in foreign affiliates.

Transnational corporations raise capital from a variety of sources at home and abroad: commercial banks, local and international equity markets, public organizations and their own corporate systems in the form of internally generated profits for reinvestment. Taking all these sources of finance into account, investment in foreign affiliates — the investment component of international production — was an estimated $1.4 trillion in 1996 (figure 1). Of this, only $350 billion, i.e., a quarter, were financed by FDI flows. This means therefore that the weight of international production is also considerably larger: expressed as a ratio of world gross fixed capital formation, about one-fifth was undertaken by

Figure 1. Actual flows of investment abroad by TNCs, 1970-1996

(Billions of dollars)



Source: UNCTAD, *World Investment Report 1997*, p. 27.

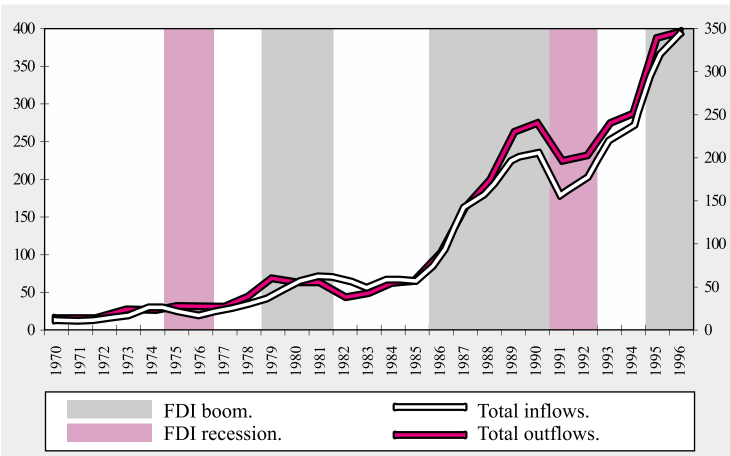
foreign affiliates. (This measure does not capture additional investment controlled by TNCs via various non-equity measures, including corporate alliances.)

Foreign-direct-investment flows set a new record level of $350 billion, in the midst of a new FDI boom, ...

Returning to FDI flows themselves, the boom that began in 1995 continues, with inflows setting a new record of around $350 billion in 1996, a 10 per cent increase (figure 2). Fifty four countries on the inflow side and twenty countries on the outflow side set new records in 1996. Unlike the two previous investment booms in 1979-1981 and 1987-1990 (the first one being led by petroleum investments in oil producing countries, and the second one being concentrated in the developed world), the current boom is characterized by considerable developing-country participation on the inflow side, although it is driven primarily by investments originating in just two countries — the United States and the United Kingdom. There are signs that an even greater number of countries will take part in

Figure 2. FDI inflows and outflows, 1970-1996

(Billions of dollars)



Source: UNCTAD, *World Investment Report 1997*, p. 11.

the present boom as it unfolds on the inward side (e.g., developing countries in Latin America), as well as on the outward side (e.g., France, Germany and Asian developing countries).

During 1995-1996, the share of developing countries in global inflows was 34 per cent. Although this is not much higher than the developing-country share during the investment boom at the beginning of the 1980s, qualitatively it reflects a wide variety of location-specific advantages enjoyed by developing countries over and above natural resources. The composition of the top developing-country recipients has also changed dramatically between these two investment booms, with oil producing countries now featuring far less prominently among the top recipients. Interestingly, the developing-country share of global inflows has been on the rise during the current boom, while during the 1987-1990 boom it declined. That decline went hand in hand with a boom in intra-developed country mergers and acquisitions (M&As), at that time in response to heightened protectionist pressures in key developed countries. As in earlier FDI booms, the bulk of FDI flows goes to a limited number of developing countries.

... with cross-border mergers and acquisitions and inter-firm agreements as the driving force behind TNC activity ...

Even in the current boom, cross-border M&As, especially in the United States and Western Europe, are playing an important role in boosting FDI, although this time there is no ensuing decline in the developing-country share of inflows. The value of such M&As increased by 16 per cent in 1996, to $275 billion. If majority-held transactions only are taken into account, the value of cross-border M&As in 1996 would be $163 billion, or 47 per cent of global FDI inflows (though the measured values are not strictly comparable) (figure 3).

Complementing the increases in M&As and FDI flows, the number of cross-border inter-firm agreements (equity and non-equity, other than strategic research-and-development (R&D) partnerships) has also increased. In 1995, nearly 4,600 such agreements were concluded, compared with about 1,760 in 1990. These agreements take place primarily between firms based in developed countries: United States firms participated in 80 per cent of them, European Union firms in 40 per cent and Japanese firms in 38 per cent. Recently, firms based in developing countries have also begun to conclude such agreements actively. The number of cross-border inter-firm agreements (other than strategic R&D partnerships) with developing-country firm participation has increased in absolute numbers, as well as a share of the world total (from 27 per cent during 1990-1992 to 35 per cent during 1993-1995). Although there was a decline in 1995, the number of strategic R&D partnerships (in core technologies, such as information technologies and biotechnology), has also been rising steadily since 1990. Again, developing-country firms assumed a bigger role in strategic partnerships (3 per cent in 1989 to 13 per cent in 1995), suggesting that these firms may have attained sufficient technological sophistication and capacity to make them worth having as partners.

Figure 3. Relationship between cross-border mergers and acquisitions and FDI, 1985-1996

(Billions of dollars and percentage)